BIS | Department for Business Innovation & Skills

# DEALING WITH DISMISSAL AND 'COMPENSATED NO FAULT DISMISSAL' FOR MICRO BUSINESSES

## International Case Studies

MAY 2012

# Contents

# Introduction

A flexible labour market is a crucial component of a growing and prosperous economy. Though the UK has a competitive employment framework by international standards, the Government believes that steps can be taken to improve it. Through the Employment Law Review, the Government is pursuing an ambitious programme of reforms to develop the framework to encourage firms to take on staff and grow. As part of this work, BIS recently issued a call for evidence seeking views on the issue of dismissing staff. The call seeks views in particular on the concept of 'compensated no-fault dismissal' for businesses with fewer than 10 employees, which would allow these employers to dismiss an employee where no fault is identified, provided a set amount of compensation is paid.

The aim of such a reform would be to allow small businesses to have the right number of people at the right time. Uninformed economic reform, however, can have adverse and unintended consequences. The Government is therefore seeking to understand the potential economic impact, including the wider impact on both employer and employee confidence, of no-fault dismissal. Bearing this in mind, BIS undertook a study of international labour market regulation. Following an initial assessment of international data BIS identified three countries with particularly relevant features to the no-fault dismissal proposal: Germany, Australia and Spain.

This paper therefore presents case studies of the dismissal procedures in those three countries. Germany and Australia were chosen as each exempts small businesses from certain unfair dismissal regulations, while Spain has recently implemented a reform akin to compensated no-fault dismissal. Though each country must be considered in context, we believe that valuable information can be gleaned from the example of each: in particular, the consequences of reform, whether unanticipated, adverse, or beneficial. We stress, however, that each country has a unique system, and throughout the case studies attempt to highlight some of the key distinctions. Though a flexible labour market is key motivating factor in the UK, in other countries, as we shall see, this is not necessarily the case.

This article will proceed in the following manner: first, some general themes are discussed, as initial concepts to bear in mind while reading the case studies. Then, each of the three countries is presented in turn, with a description of the most recent relevant reforms, followed by background, including broader international statistics, to frame the context of the discussed reforms. Each case study concludes with statistical analysis of subsequent labour market trends to give the reader a sense of what has happened since.

The presented results are intended to stimulate reflection and debate about the UK's dismissal processes. The case studies represent our best efforts at assessing the current situation in each, with full awareness that there is room for further input and clarification. We invite readers to share any additional knowledge of these or other relevant systems in addition to commenting on these studies as presented. These views should be fed into BIS through its call for evidence on dismissal. Details of this are available at:

http://www.bis.gov.uk/assets/biscore/employment-matters/docs/d/12-626-dismissal-for-micro-businesses-call.pdf

# I- Economic and legal themes surrounding dismissal regulations

## 1- Job turnover and micro businesses

It is generally accepted that micro businesses have the greatest rate of job turnover. Most countries tend to show a negative correlation between size of firm and job reallocation (OECD *Employment Outlook*, 2009).

Several studies highlight the impact of employment protection on job and worker flows and its indirect consequences on the economy. They demonstrate that less employee protection generally tends to increase labour inflow (hiring) and outflow (firing), although the general effect on level of employment is indeterminate. In turn, this leads to greater labour reallocation efficiency and reduces job tenure and unemployment duration (Lazear, 1990; Bassinini 2011).

## 2- Impact of economic environment on tribunal/court decisions

Although the degree of employee protection significantly influences the level and outcome of tribunal/court claims, previous evidence has shown that economic conditions also have an impact. In particular, tribunals/courts are more likely to find in favour of the employee for unfair dismissal cases when the economic environment is unfavourable (Polo and Rettore, 2003; Cho and Lee, 2007; Marinescu, 2007).

## 3- Collective bargaining

The consideration of dismissal costs need not be restricted to costs stipulated by legislation. Often, collective agreements on employment conditions provide greater employee protection, most notably in terms of longer notice periods and/or higher severance payments. In addition, whether the agreement exists at the national, industry, or company level matters since the degree of flexibility and negotiation between employees and employers may differ significantly across these levels.

The level of coverage differs significantly across countries (see Annex 3): in Spain 80% of the workforce is included, while Australia and Germany have a more moderate level at around 60%, with most at the company and industry levels, respectively. In the United Kingdom, on the other hand, coverage is 35%.

## 4- Severance payment and its impact on firing/hiring decisions

Dismissal costs significantly impact firing and hiring decisions. Theoretical considerations posit that a firm's decisions arise from a strict comparison between the cost of dismissal and the net benefit of employing the worker (wage-output gap). In Annex AA.1 we present statutory severance payments for a large range of countries.

We can see that severance payments vary considerably across countries. In particular, severance payments tend to be greater in European countries. With no statutory severance payments, the United States is a uniquely developed country which provides no guaranteed compensation to employees in the case of (unfair) dismissal. In the meantime, the United Kingdom and Canada are two of the least *generous* countries in the sample with severance payment varying from 0.15 to 0.56 months of salary for 2 years of tenure, and from 1.3 to 4.4 months of salary for 20 years or more of tenure. For the same years of tenure, Germany offers greater compensation with an amount equal to 1 and 10 months of salary, respectively. Spain is one of the most *generous* countries in the sample (the most generous European country, in fact) with compensation going from 0.3 months of salary for 6 months of tenure to 1.5 months for 2 years of tenure and reaching a value of 12 months of salary after 20 years of continuous service.

Partially as a result of these differences, a change in firing costs is likely to generate different degrees of reaction from employers depending on which country is involved.

Also, it is likely that the administrative costs linked to a dismissal procedure have a significant impact on the employers' decisions to proceed effectively to the dismissal. Unfortunately, sources of information on these costs are generally difficult to find and thereby are absent from the analysis.

## 5- Temporary employment

The interaction between permanent and temporary workers is an important aspect to consider in the analysis of unfair dismissal reform. A change in condition of employment for permanent workers will indirectly impact conditions for temporary workers.

Conditions for temporary employment vary significantly between countries. Although the specifics of employment conditions will be undertaken for each case study, we proceed in this section to a preliminary cross-country comparison of temporary employment. In Table A, we report the results from the OECD Employment Protection Index for 2008. This index is the most widely used indicator used to evaluate the stringency of employment legislation overall. Results indicate that regulation on temporary employment differs significantly between countries. Australia and United Kingdom are among the least regulated on the list, with an index of 0.79 and 0.29, respectively. On the other hand, Germany appears much more regulated with an index of 1.96, while Spain stands at the top of the ranking with an index of 3.83.

**Table A: OECD index of Employment Protection**

| | Regulation on temporary forms of employment | OECD employment protection index |
|---|---|---|
| **Australia** | **0.79** | **1.38** |
| **Belgium** | 2.67 | 2.61 |
| **Denmark** | 1.79 | 1.91 |
| **France** | 3.75 | 3.00 |
| **Germany** | **1.96** | **2.63** |
| **Italy** | 2.54 | 2.58 |
| **Netherlands** | 1.42 | 2.23 |
| **Spain** | **3.83** | **3.11** |
| **Sweden** | 0.71 | 2.06 |
| **United Kingdom** | **0.29** | **1.09** |
| **United States** | 0.33 | 0.85 |

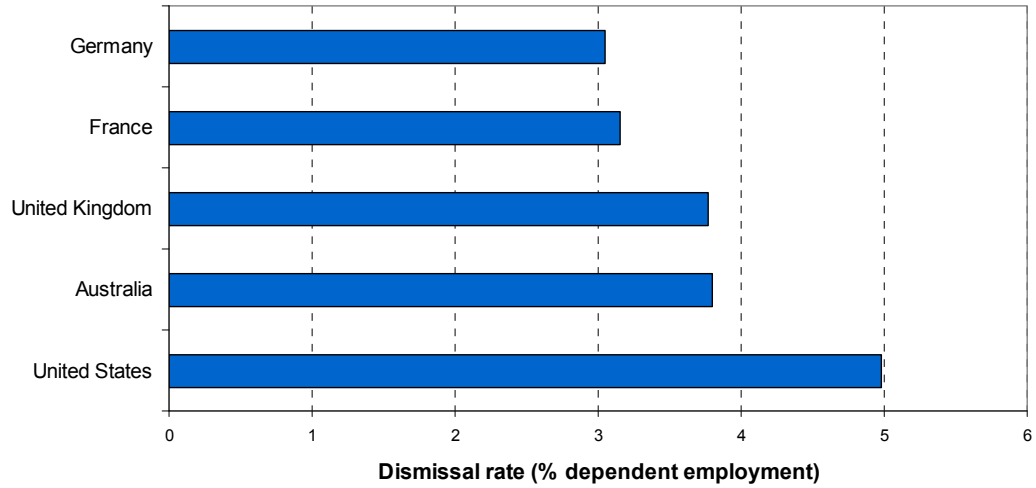
*Source*: OECD.

## 6- Dismissal rates across OECD countries

A clear understanding of the structure of job separations within each country is fundamental for our analysis. Differences between voluntary separations (initiated by the employee) and involuntary separations (initiated by the employer) generally lead to different implications in terms of employment protection. It is often argued that relaxing dismissal regulations in a country relying mainly on involuntary separations has a greater impact on the labour market than a similar reform in an economy with lower involuntary separations.

Although accurate data on job separations are few in the literature, OECD provides an estimated comparison of average dismissal rates (a proxy for involuntary separations) for five countries: the United States, Australia, United Kingdom, France, and Germany. Graph 1 below presents the results[1]:

**Graph 1: average dismissal rates for selected countries**




*Source:* OECD Employment Outlook (2009)

At 5%, the United States has the highest dismissal rate of the sample. The United Kingdom and Australia have similar rates at approximately 3.6%, while Germany and France have a lowest rate at 3%. No significant conclusions, however, should be drawn from this chart. The rate of dismissal should ideally be assessed in comparison with the proportion of voluntary separations (resignation, etc.). Unfortunately, we do not have any empirical data making such a cross-country comparison.

[1] Figures presented in the table are adjusted for industry composition.

Overall, the data presented in this section indicates that dismissals and hiring tend to be highly susceptible to country-specific factors. As we have seen in Table A, this influence partly results from differences in labour market regulations and temporary employment.

# II- Case studies

## A - Germany

In 2004, the German government amended its small establishment exemption from unfair dismissal regulations to include any establishment with fewer than 10 employees. Previously, only businesses with fewer than five employees were excluded. This exemption was part of a set of reforms called AGENDA 2010, aimed at tackling the structural causes of unemployment[2] in Germany, which had remained worryingly high at around 8% over the previous decade (see Annex 4). By the time of the reform, the level of unemployment had reached 10% (OECD). Bear in mind, however, that as the threshold exemption has been in existence from some time, merely toggling between five and ten employees, this reform was a relatively small change.

### 1- Reform background

#### 1.1 Definition

Statutory protection against dismissal in Germany is established by both the *German Civil Code* and the *Protection against Dismissal Act (PADA)*.[3] The latter can be compared to the UK's *Employment Rights Act* enacted in 1996**.** Under *PADA* small establishments are exempted from unfair dismissal regulations.[4] Initially, the threshold for a small establishment was set at five employees. In October 1996, the centre-right government changed the threshold to 10 employees. Then in January 1999, under a newly appointed centre-left government, regulation was tightened, and the threshold scaled back down to five employees. In January 2004, the government modified *PADA* again. The *Termination Protection Act,* a subsection which regulates conditions under which the employment relationship can be ended, was amended to exempt establishments[5] with less than 10 employees from dismissal regulations. This threshold was previously in place between 1996 and 1999, but had been reduced to five employees.

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[2] Causes of unemployment which do not rely on economic conjecture.

[3] PADA is called *Kündigungsschutzgesetz* in German, enacted 1969, last amended March 2008.

[4] Such employees still may seek redress via other routes, including filing a discrimination claim. Under the *Works Constitution Act*, the employer and the works council are obligated to ensure an employee is not discriminated against on the basis of race, creed, national origin, political or trade union activity, convictions, gender, or sexual identity.

[5] At this point, it is important to make a distinction between establishments and firms. A firm can exist in one location or have many locations while establishments generally refer to a single location. Therefore, a single firm often consists of many separate establishments.

Some groups are not covered by the dismissals regulations of *PADA.*[6] In 2008, the percentage of the workforce covered was estimated to be 58.5%, meaning that slightly more than half of workers fell under its ambit.

[6] Including self-employed individuals, civil servants [regulated by *Bundesbeamtebgesetz*], members of the armed forces [regulated by *Soldatengesetz*], apprentices and temporary workers.

## 1.2 Scope

The majority of German businesses are small and medium enterprises. There were 1,028,917 micro businesses in 2004, representing 82.4% of the total number of firms (see Table A.1 below). In addition, these firms employed 2,525,024 employees, or 16% of the total workforce. By way of comparison, the figures for the UK are as follows: the number of micro businesses is currently evaluated at 4,332,565, or 95.4% of all enterprises, and the number of employees was 3,651,000, equivalent to a proportion of 15.7% of the workforce.[7]

These numbers do not reflect, however, some disparities across sectors. As reported in Table A.1, the construction and hotel-restaurant sectors were largely comprised of micro businesses (83% and 81.5%, respectively) while manufacturing relied on larger enterprises (60%).

**Table A.1: Proportion of micro businesses in total economy and by sector (2004)**

| | Number of enterprises | | Number of employees | |
|---|---|---|---|---|
| **Whole economy** | Number | % | Number | % |
| Micro businesses | 1028917 | 82.40 | 2525024 | 16.01 |
| All businesses | 1248756 | 100 | 15771623 | 100 |
| | | | | |
| **Sector** | | | | |
| Hotel restaurant | 138,193 | 84.0 | 468,840 | 40.28 |
| Transport | 70,536 | 77.1 | 212,764 | 11.51 |
| Real estate | 511,137 | 90.75 | 1,052,359 | 26.45 |
| Manufacturing | 119,652 | 60.0 | 362,537 | 5.13 |
| Electricity | 1,696 | 51.0 | 5,483 | 1.93 |
| Construction | 187,703 | 83.0 | 423,041 | 29.60 |

*Source:* Eurostat

[7] Figures taken from the *Business population estimates* survey for the UK. See http://www.bis.gov.uk/assets/biscore/statistics/docs/b/bpe_2011_stats_release.pdf for more information, including the complete statistical release.

# 2 - Institutional features and dismissal procedure in Germany

## 2.1 Grounds for dismissal

*PADA* stipulates that an employer may dismiss an employee if the reason is *socially justified* and the proper procedure is followed. Socially justified reasons include:

a) Conduct: any breach of duty arising from the employment relationship where the employee is at fault.
b) Urgent business requirements / operational reasons: where the role itself is abolished for reasons pertaining to the business, i.e., redundancy. A termination in this circumstance is only permissible where the employee cannot be employed elsewhere in the company.
c) Other personal circumstances: reasons related to the employee's circumstances, such as frequent absence due to illness.

## 2.2 Notification of dismissal procedure and probationary period

The notification of dismissal must be issued in writing by the employer and the original must be given to the employee. The notice period commences the day the employee receives the letter. An employee then has three weeks to file a claim for unfair dismissal. If he or she does not make a claim within this length of time, the dismissal will be deemed effective. If the claim does go to the labour court the burden of proof is on the employer to show that the dismissal was reasonable.

The probationary period is six months. During this period, the minimum statutory notice period is two weeks. Otherwise the minimum statutory notice period is as set out in Table A.2:

**Table A.2: Minimum Statutory Notice Periods in Germany**

| Length of service | Notice period |
|---|---|
| Less than 2 years of service | 4 weeks |
| 2 years of service | 1 month |
| 5 years of service | 2 months |
| 8 years of service | 3 months |
| 10 years of service | 4 months |
| 12 years of service | 5 months |
| 15 years of service | 6 months |
| 20 years of service+ | 7 months |

## 2.3 Remedies and severance payments

In Germany claimants must file unfair dismissal applications with the appropriate labour court. Another notable feature of Germany is that the majority of legal rules have developed through legal practice rather than by statute.

Reinstatement is the primary remedy, though either party may request compensation instead. If the former remedy is awarded, the employment relationship continues and the employee will be entitled to remuneration for the period between the end of the notice period and the court's decision. There are no statutory severance payments for dismissal, however; compensation can be paid and this is decided on a case-by-case basis. There is no statutory cap on the amount of compensation. Nevertheless, the following formula is usually applied:

*Monthly salary multiplied by years of employment multiplied by likelihood of the termination will be declared unlawful.*[8]

In practice, the majority of cases involve a settlement agreement before the court leading to a severance payment. Such agreements are quite popular in Germany since they do not require the consent of the works council or any other government body, provide greater certainty in terms of severance payment, and employers prefer them because the socially justified standard is high. Typically, the amount due to be paid to the employee is equal to 0.5 months' salary for each year of employment. Table A.3 below illustrates this:

**Table A.3: Typical Severance Payments in Germany**

| **Length of Service** | **Months of salary** |
|---|---|
| 6-9 months | 0.5 month |
| 9 months-1 year | 0.5 month |
| 1-2 years | 0.5 month |
| 2-4 years | 1 month |
| 4-5 years | 2 months |
| 5-10 years | 2.5 months |
| 10-20 years | 5 months |
| 20 years+ | 10 months |

[8] This likelihood (also called severance pay factor) is often around 0.5.

## 2.4 Role of third parties

### *2.4.1 Collective bargaining*

In Germany, collective bargaining agreements often govern the rights and obligations of employers and employees. These agreements regulate the content, commencement, and termination of the employment relationship. It is often the case that parties not bound by the agreement add it to their employment contract. Though there are no pre-determined rules for dismissal for collective agreements, collective agreements frequently determine the notice period and exclude dismissals for economic reasons within a certain period.

The role of collective bargaining for pay and conditions in the workplace is principally based at the industry/sector level. Negotiations at the national level are rare. The latest figures from the OECD indicate that 62% of German employees are covered by collective agreement. This relatively low level (see Annex 3) in comparison with other EU States can be explained by the fact that most agreements are at the firm level, via works councils (see next section).

### *2.4.2 Works councils and dismissal procedure*

A works council is a group of employees which exists at the firm level to ensure that decisions taken by the employer do not damage employees' rights. Its scope of intervention resides essentially in social issues such as determination of working hours, holidays.

In Germany, works councils are the primary form of workplace representation (the law does not accord additional importance to unions). They provide representation uniquely for employees and can be set up in all private businesses with at least five employees (*Works Constitution Act*, 2001). Works councils must be consulted on issues related to dismissal decisions, but cannot veto a procedure, unless the dismissal interferes with existing agreements.

*PADA* stipulates that in the absence of a works council, termination of the employment relationship becomes effective once the employee receives the original notice of dismissal. If a works council exists, however, it must be informed of the reason for the dismissal before notification is given to the employee. The works council must reply within one week, but does not have any enforcement power. The works council can, nonetheless, extend or postpone the procedure (from a week up to more than nine months). In addition, if the employer fails to contact the works council, the dismissal will be automatically deemed invalid (Section 102 *Works Constitution Act*).

Finally, members of a works council benefit from special protection against dismissal. They can be dismissed only for *good cause* (i.e., gross misconduct) and only with the approval of the works council.

## 2.5 Special features of note

### *2.5.1 Fixed-term contracts*

In Germany, one important way to avoid the costs of dismissal relies on the use of fixed-term contracts, also called employee leasing (see Box 1). A fixed-term contract can either end on a certain date or upon completion of a specific task. In this way, fixed-term contracts permit the employer greater flexibility in terms of employee management.[9]

[9] Until recently, employers needed to provide a reason for employing fixed-term employees, such as staff adjustment.

***Box 1: Leasing employees in Germany***

Employee leasing, a concept which does not exist in Anglo-Saxon countries, occurs when one employer hires out an employee to another employer on a temporary basis. Since the enactment of the *Employee Leasing Law* in 1972, leasing has become a popular method of reducing labour costs in Germany. Leasing an employee requires prior permission from the current employer (the *lessor*) and is subject to various legal restrictions:

(a) The lease contract is concluded between the lessor and the *hirer.* The content of the contract is enforceable and regulates the main aspects of employment, such as the position, the lease period, and remuneration. In addition, there is no longer any limit to the duration of the lease.[10]

(b) The hirer employs the leased employee for the targets and aims of his or her own business. As a result, the leased worker is fully integrated into the business of the hirer.

(c) Finally, the leased employee is entitled to the same terms and conditions of employment as permanent employees in the hirer's company.

Interestingly, there are some admissible forms of *unlicensed* employee leasing, which are principally used by small businesses in order to avoid layoffs.[11]

[10] There has been no time restriction on leased employment since 2004. Prior to this date, since 2002 an employee could be leased for a duration of up to 24 months.
[11] To obtain a licence, a procedure has to be followed and fee of £250 has to be paid by the lessor. For more explanation on the rights and conditions for employment leasing, see Schuren (2005).

### *2.5.2 Mini jobs*

The way each country's system works depends on their individual tax and regulation systems. In Germany, social security taxes tend to be higher than in the UK. To offset this Germany has chosen to introduce the 'mini job' concept. Part time workers who earn less than €400 per month are considered to be employed in mini jobs. Employers do not have to pay social security or taxes on behalf of these workers. Mini jobs can thus been seen as an inexpensive source of labour relative to 'standard' jobs.

### *2.5.3 The principle of proportionality*

The principle of proportionality is an essential concept to take into consideration for every dismissal occurring under *PADA*. This principle states that a dismissal is only lawful if termination of employment is the solution of last resort for the employer. An employee can only be dismissed if he or she cannot be employed in another position in the same establishment or another establishment within the same company. The principle of proportionality also requires that all aspects of the case are taken into consideration by the tribunal. Therefore, it is often argued that this principle, while giving employees additional protection, also creates additional uncertainty concerning the outcome of an unfair dismissal claim.

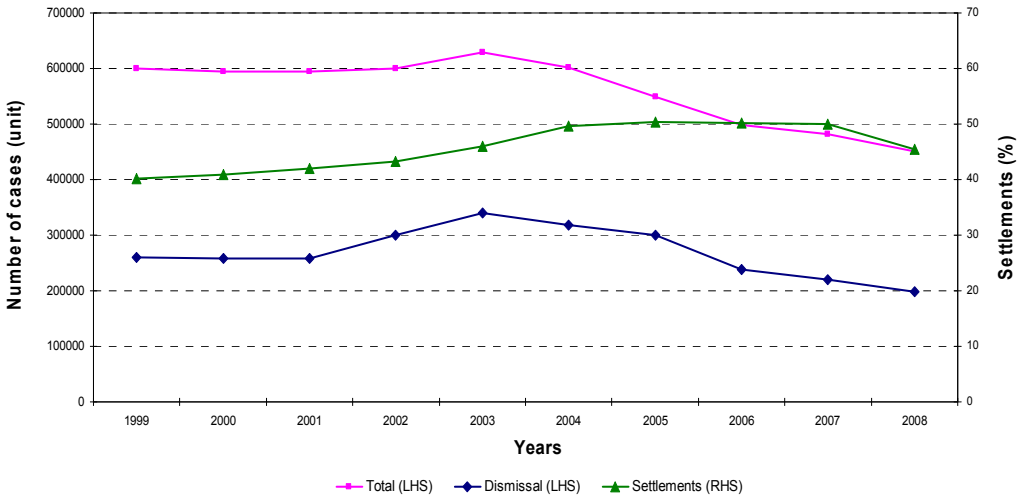
# 3- Years following the reform

## 3.1 Dismissals and total claims

Chart A.1 presents the number of cases filed in labour courts (total and dismissal) along with the percentage of settlement deals for the period 1999-2008.

Between 1999 and 2003 the number of cases for dismissals and total cases has steadily increased, reaching a peak of 340,000 and 620,000 cases, respectively.[12] In 2004 this trend reversed and numbers have continued to decline since then. On the other hand, the proportion of settlements increased from 41% in 1999 to around 50% in 2004, before dropping back slightly in 2008.

**Chart A.1 : Number of cases filed in labour courts (dismissal and total) and proportion of settlements (1999-2008)**



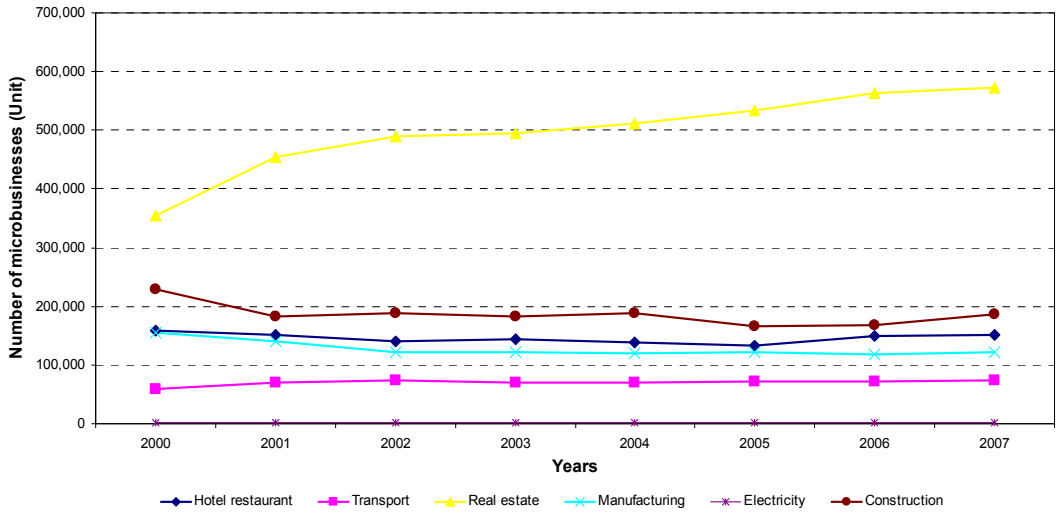

*Source*: German Federal Statistical Office.

[12] A similar trend is not surprising given that the number of dismissals constitutes more than 50% of labour court cases during this period.

## 3.2 Industry distribution of micro businesses

Chart A.2 presents the number of micro businesses by type of industry. As we can see, the figures do not suggest that the introduction of *PADA* resulted in a significant growth of micro businesses. Except for the real estate sector, which displays a noticeable increase from 500,000 to slightly less than 600,000 between 2004 and 2007, numbers in the remaining sectors remain remarkably stable. On balance, it seems more likely that the increase of micro businesses in the real estate sector is the result of a general development of the financial sector rather than the consequences of the single impact of *PADA*.

**Chart A.2: Number of micro business (1-9 employees), by industry (2000-07)**

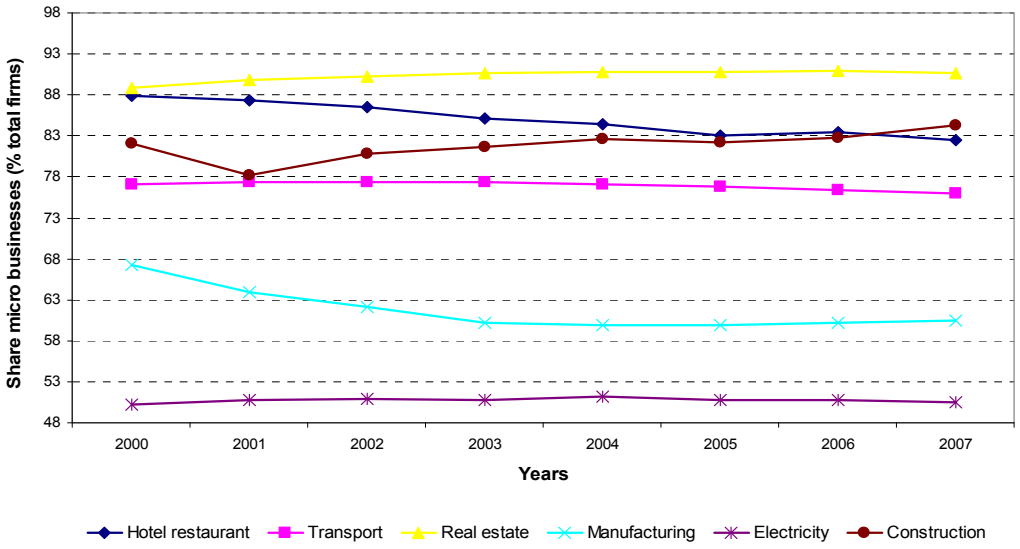



*Source*: Eurostat.

In addition, Chart A.3 depicts the proportion of micro businesses in the economy by sector from 2000-2007. As seen previously, these figures vary across sectors. But here again, we see that they remain relatively stable over the period considered for all sectors. Especially after 2004, figures remain almost unchanged.

As a result, the graph does not present any explicit evidence that the reform has triggered a stimulant effect in terms of new businesses, including in sectors comprised mainly of micro businesses (construction, real estate and business, hotel/restaurant).

**Chart A.3 : Percentage of micro businesses (1-9 employees), by sector (2000-07)**

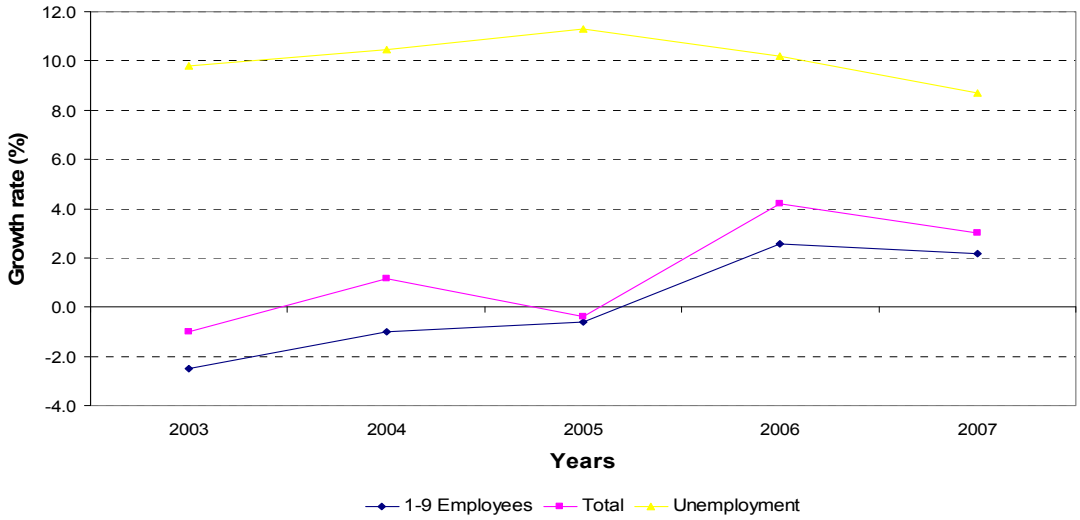



Source: Eurostat, author's calculations.

## 3.3 Impact on the level of employment

Chart A.4 reports the growth rate of employment for micro businesses and the economy for the period 2003-2007. Even though the time period is somewhat limited, we can see that the growth rate of employment for micro businesses consistently fell below the overall growth rate of employment. This trend suggests that the reform has not encouraged micro businesses to expand more quickly than larger businesses.

**Chart A.4: Growth rate of employment and unemployment (2003-07)**




*Source*: Eurostat

## 3.4 Unintended consequences of the reform: deregulation focuses principally on temporary workers

As previously mentioned, the reform was aimed at releasing small business employers from the burden of regulation. While the German labour market has improved in recent years, there is no clear evidence that this stimulation was caused by the threshold amendment to *PADA*, as opposed to any of the other reforms implemented around that time.

This reform was expected to stimulate employment and productivity. Rather, we have witnessed a consistent growth of temporary employment and the further development of a dual labour market, along with a lack of growth for micro businesses.

A possible reason is the relaxation of temporary worker protection rather than a lack of initiative to ease regulation of permanent contract workers. From 2002, the German government undertook significant labour market reforms, first via the *Job AQTIV Act*, and second with the Hartz Commission. Both encouraged the utilisation of temporary workers by allowing the employer to hire a worker for a duration of up to two years, as well as the opportunity to repeatedly employ the same person in temporary employment. These reforms have thus led to the type of fixed-term (notably leased employment) and temporary contract discussed previously.

Simultaneously, the creation of a threshold may have encouraged employers to hire more temporary workers – who are not counted as employees and thus excluded from the headcount – in order to remain below the threshold.[13]

[13] Note that a part of the literature argues that employers would rather choose to split their activity into several establishments instead of increasing employment so that they remain below the threshold (see for example Borgarello *et al.,* 2003). However, results from Chart A.4 tend to reject this hypothesis for Germany.

# B- Australia

In June 2009, the newly elected Labour government enacted substantial modifications to the legislative system of employment. This reform was implemented via the *Fair Work Act 2009*, which introduced new regulations for small businesses. Prior to this act, businesses with fewer than 100 employees were exempt from unfair dismissal regulation. The *Fair Work Act* did away with this exemption, opting instead to give businesses with fewer than 15 employees a different set of regulations to follow. This reform, clearly, was a more drastic change than that of Germany.

Unlike the German *PADA*, this reform did not arise from a demand for greater flexibility from employers but was instead a consequence of a larger reform initiated by the previous government. The reform was considered an attempt to create conditions for a fairer labour market: an issue that we will address in the last section of this case study.

## 1- Reform background

### 1.1 Definition

Under the *Fair Work Act*, businesses with fewer than 15 employees are subject to less onerous regulations which reflect their smaller size. The predecessor to this act, the *Workplace Relations Amendment Act 2005* (*Work Choices*),[14] exempted businesses under 100 employees entirely from regulation.[15]

Under the *Fair Work Act,* small businesses must instead adhere to the *Small Business Fair Dismissal Code (The Code)*. While the Code itself is only three brief paragraphs, Fair Work Australia (FWA, the body which administers the *Fair Work Act*) created a ten question checklist as an additional aid. As this checklist has no legal status, an employer who follows it may still be held liable if he or she did not respect the Code in its entirety. Small businesses (i.e., those with fewer than 15 employees) also have a longer qualifying period before their employees acquire the right to claim unfair dismissal: one year as opposed to six months for larger businesses.

[14] Introduced by the former Howard government (2004-07).
[15] As in the case of Germany, employees could still seek redress via other legal avenues.

## 1.2 Scope

As in the case of Germany, the Australian economy features large numbers of small businesses (1-20 employees). As seen in Table B.1, in June 2009, the number of small businesses was calculated at 1,961,337, or 95.6% of all businesses in the country. In terms of employees, 4,747,000 were working in small firms, representing 47.2% of the workforce.

**Table B.1: Proportion of micro businesses in total economy and by sector (June 2009)**

| | Number of enterprises | | Number of employees | |
|---|---|---|---|---|
| **Entire economy** | Number | % | Number | % |
| Small businesses | 1,961,337 | 95.6 | 4,747,000 | 47.2 |
| All businesses | 2,051,085 | 100 | 10,057,000 | 100 |
| | | | | |
| **Sector** | | | | |
| Agriculture, forestry and fishing | 199,312 | 84 | 400,000 | 85.7 |
| Mining | 7,225 | 77.054 | 20,000 | 13.9 |
| Manufacturing | 81,051 | 90.75312 | 288,000 | 30.2 |
| Services | 1,629,978 | 60 | 4,040,000 | 47.6 |
| Not Classified | 43,801 | 99.4 | | |

*Source:* Australian Business Statistics.

# 2- Institutional features and dismissal procedure in Australia

## 2.1 Grounds for dismissal

Under section 385, an individual dismissal is fair if:

a) The dismissal has not been *harsh, unjust, or unreasonable*. These terms include many reasons, such as whether there was a valid motive for the dismissal related to capability or misconduct, and whether the person was given any opportunity to respond to that charge (see *Box 2*).
b) The dismissal was a case of *genuine redundancy*, meaning that the employer no longer needs the job to be performed by anyone because of changes in the operational requirement of the employer's enterprise.
c) The dismissal was consistent with the *Small Business Fair Dismissal Code* (if applicable).

## 2.2 Notification of dismissal procedure and probationary period

The notice period is determined by the *National Employment Standards* and is based on the length of tenure and the age of the employee, as shown in the Table B.2 below:

**Table B.2: Minimum Statutory Notice Periods in Australia**

| **Tenure / Age** | **< 45 years old** | **> 45 years old** |
|---|---|---|
| Not more than one year | 1 week | 1 week |
| Between 1 and 2 years | 2 weeks | 2 weeks |
| Between 2 and 3 years | 2 weeks | 3 weeks |
| Between 3 and 5 years | 3 weeks | 4 weeks |
| 5 years + | 4 weeks | 5 weeks |

The notice period is increased by one week if the employee is over 45 years old and has completed at least two years of continuous service with the employer by the end of the day that notice is given.

**Box 2: What is harsh, unjust or unreasonable?**[16]

When considering whether a dismissal was harsh, unjust or unreasonable, FWA must take into account the following criteria:

(a) Whether there was a valid reason for the dismissal related to the person's capacity or conduct (including its effect on the safety and welfare of other employees); and

(b) whether the person was notified of that reason; and

(c) whether the person was given an opportunity to respond to any reason related to the capacity or conduct of the person; and

(d) any unreasonable refusal by the employer to allow the person to have a support person present to assist at any discussions relating to dismissal; and

(e) if the dismissal related to unsatisfactory performance by the person, whether the person had been warned about that unsatisfactory performance before the dismissal; and

(f) the degree to which the size of the employer's enterprise would be likely to impact the procedures followed when proceeding to the dismissal; and

(g) the degree to which the absence of dedicated human resource management specialists or expertise in the enterprise would be likely to impact on the procedures followed in effecting the dismissal; and

(h) Any other matters that FWA considers relevant.

Section 383 of the *Fair Work Act* determines an employee's probationary period, which is based on the size of the firm:

a) One year for a small business (less than 15 employees)
b) Six months otherwise

[16] *Fair Work Act* 2009, Chapter 3 Part 3-2 Division 2 §387.

It is worth noting that unfair dismissal provisions of the *Fair Work Act* only apply to individuals employed by national system employers.[17] A national system employee is only eligible to claim unfair dismissal if one of the following criteria is satisfied:

a) a modern award covers the person; or
b) an enterprise agreement applies to the person in relation to employment; or
c) the employee receives an annual rate of earnings below $118,100.[18]

### 2.3 Remedies and severance payments

Reinstatement is the primary remedy for unfair dismissals. In that circumstance, the employee must be reappointed to the position he or she held before the dismissal or in another position with terms and conditions at least equal to the previous position.

Compensation can be ordered if the tribunal considers that it is more appropriate than reinstatement. To make this determination, the tribunal must take into account all the circumstances of the case, including:

a) The effect of the order on the viability of the employer's enterprise; and
b) the length of the person's service with the employer; and
c) the remuneration the person would have received, or would have been likely to receive, if the person had not been dismissed; and
d) the efforts of the person to mitigate the loss suffered by the person due to the dismissal; and
e) the amount of any remuneration earned by the person from other work between the dismissal and the order; and
f) the amount of any income reasonably likely to be so earned between the making of the order and the actual payment of the compensation; and
g) any other matter considered by FWA to be relevant.[19]

[17] This category includes constitutional corporations (these are corporations that are trading or financial), the Commonwealth or a Commonwealth authority, any employers in Victoria, the Northern Territory or the Australian Capital Territory, and employers interstate or overseas trade or commerce, but only for certain categories of employee.
[18] Value indexed from 1 July 2011.
[19] *Fair Work Act* 2009, Act No. 28 of 2009 as amended, Ch. 3, Part 3-2, §392 (2).

The maximum compensation cap is the lesser between:

a) Half the amount of the high income threshold ($59,050 from July 2011[20]); or
b) the amount of remuneration received in the 26 weeks prior to dismissal

In addition to compensation for the decision, the tribunal may order costs against a lawyer. Typically, each party must pay the costs associated with hiring a lawyer or agent to represent them. A party can, however, apply to FWA for a costs order against the opposing lawyer or paid agent[21] within 14 days following the conclusion of the matter. FWA may make such an order if that lawyer/agent caused the filing party to incur costs in two circumstances: first, because he or she encouraged their client to start or continue the matter even though success was unlikely, or second, because of a lawyer or agents' unreasonable act or omission in relation to the matter.

### 2.4 Role of third parties

Australia does not have works councils, while employee representatives must neither be notified nor approve of individual dismissals. In addition, these representatives are not specially protected.

## 3- Years following the reform

### 3.1 Trends in unfair dismissal claims and tribunal outcomes

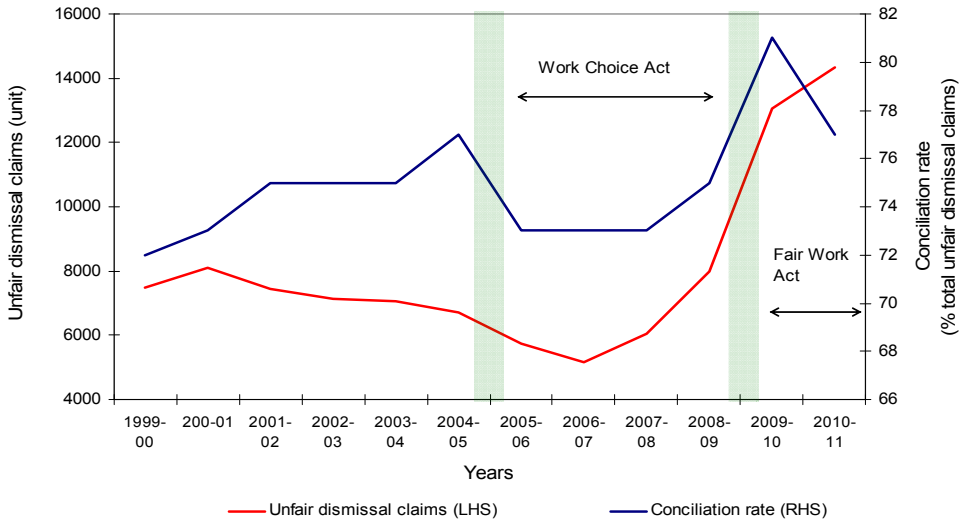
The procedure for an unfair dismissal claim is a kind of multi-tiered dispute resolution system. After FWA has deemed an application complete and valid and the employer is given a chance to respond, FWA tries to help the party resolve the dispute through conciliation. Should this fail, the FWA makes a determination. The employer may raise jurisdictional and other objections, if none of the former is found FWA decides the case on the basis of merit, via arbitration. This process is based on that which was used by the *Australian Industrial Relations Commission* (AIRC)[22].

[20] Compensation indexed annually for inflation.
[21] Assuming that FWA has granted permission for a person to be represented by a lawyer or paid agent.
[22] AIRC is an independent tribunal which dealt with unfair dismissal claims before FWA existed.

Chart B.1 presents the number of unfair dismissal claims brought before AIRC along with the rate of conciliation for 1999-2011.

The number of unfair dismissal claims steadily declined from 1999 to 2006. We can see a drop off from mid-2004 until mid-2006 which may correspond to the loosening of unfair dismissal regulation via *Work Choices*. Yet the number of unfair dismissal claims rebounded from 2006, and continues to grow at an even greater rate from mid 2008 to mid 2009. Though *Work Choices* was first implemented in 2005, its effects might not have been felt until later. The number of unfair dismissal claims fell with the introduction of the *Fair Work Act*; however, it is unclear that this legislative change caused the drop.

**Chart B.1: Unfair dismissal claims and rate of conciliation (1999-2011)**




*Source*: AIRC annual and quarterly reports

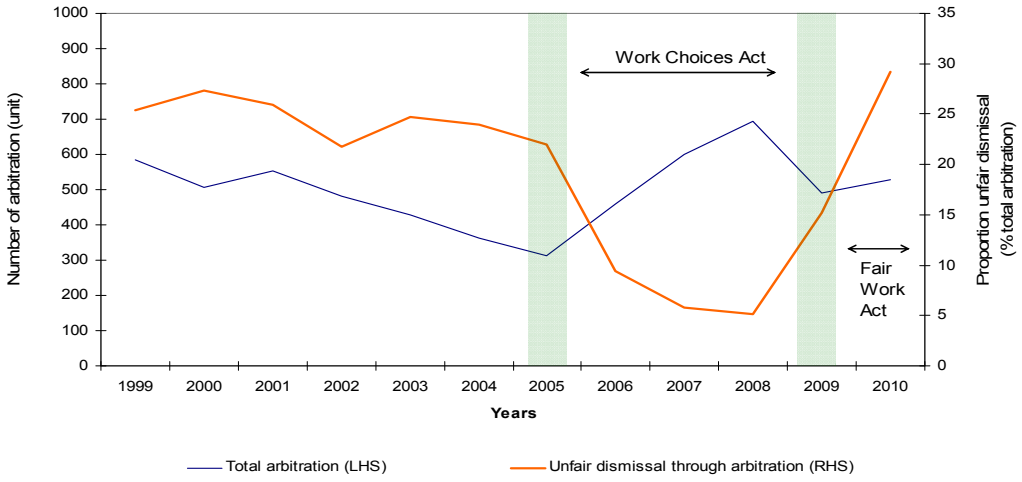
Meanwhile, the rate of conciliation increased initially, then declined from 2004 until mid-2005, where it stabilised and then increased from 2007 until 2010, peaking at 81%. In mid 2009, however, it sharply dropped again. It is unclear whether the increase is caused by *Work Choices*, as rate of conciliation can be influenced by many factors, e.g., improvements in conciliation service, or employers' or employees' willingness to settle. The timings of the spikes and dips do not correlate with changes in the number of unfair dismissal cases.

Chart B.2 presents the total number of arbitrations along with the proportion of arbitrated unfair dismissal claims in which the claimant prevailed from 1999-2010. Despite a significant increase in total number of unfair dismissal claims before AIRC (see Chart B.1 above), the number of cases going to arbitration remained fairly stable: in 2008, a year before the reform, the number of total arbitrations was established at 693. In 2009, the number slightly decreased to

492 and is currently estimated at 527. This relative stability is likely explained by the fact that most of the increase in total unfair dismissal claims has been offset by an increase in rate of conciliation, leaving the number of arbitrations relatively unchanged.

Interestingly, the 15 employee reform has been accompanied by a significant increase in arbitrated unfair dismissal cases resolved in favour of the claimant. In 2008, this proportion hovered around 5%, while, in 2010, it stood just below 30%. So while arbitral proceedings remain relatively more favourable to employers, the outcome of these proceedings has increasingly favoured employees since the *Fair Work Act*.

**Chart B.2: Total arbitration and proportion of successfully arbitrated unfair dismissal claims (1999-2010)**



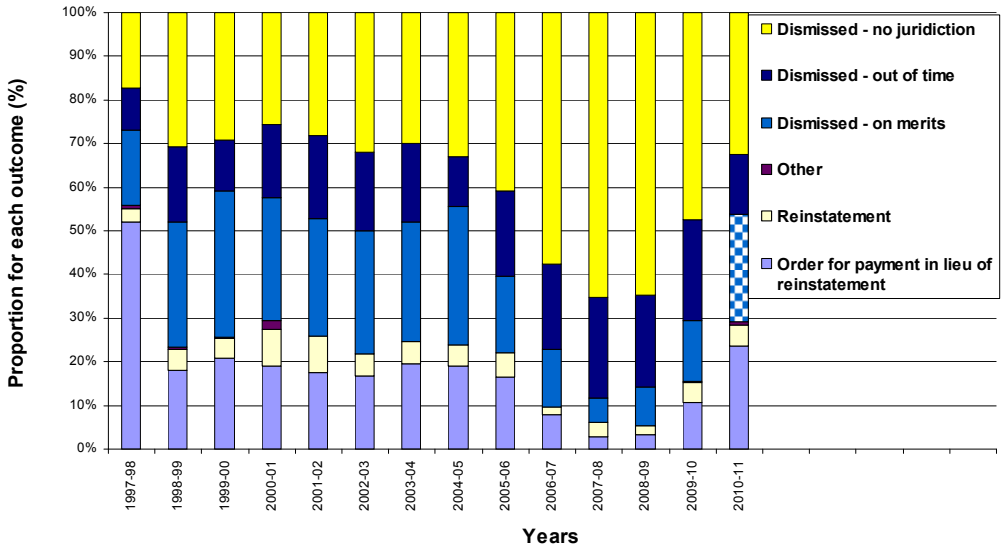

*Source*: AIRC annual and quarterly reports; author's calculations.

In order to evaluate more precisely the direct impact of the reform on tribunal outcomes, Chart B.3 below presents the distribution of outcomes for unfair dismissal applications for the period 1996-2011. The proportion of unfair dismissal claims rejected on jurisdictional grounds (yellow area), which includes the threshold exemption, is positively correlated with the degree of regulation on small businesses. Indeed, we can see a significant increase in dismissed claims following the introduction of *Work Choices*, from 32% in 2004-2005 to just below 60% in 2006-2007.[23] This trend subsequently

[23] The year 2005 is likely to underestimate the effects of the reform since it was implemented in July 2005.

reversed following the introduction of the *Fair Work Act.*[24] The percentage of dismissed claims fell to around 50% in 2009-2010 with an estimated further decrease to 32% for 2010-2011.

**Chart B.3: Outcome of unfair dismissal claims (1997-2011)**




Note: estimated value for *dismissed on merits* year 2010-11.

*Source*: AIRC Annual and quarterly reports

Finally Chart B.4 presents the distribution of unfair dismissal claims dismissed on jurisdictional grounds. Chart (a) shows the results under *Work Choices* while Chart (b) reports the outcomes for the year 2010-2011, under the *Fair Work Act*.

First, we observe that the total number of unfair dismissal claims dismissed fell drastically following the implementation of the *Fair Work Act*. In 2009-10, the number was estimated at 437, while in 2010-11 it was 221.

Second, a negligible proportion of unfair claims were dismissed because of the employer's adherence to the *Small Business Code*. In 2009-10 this number was marginal, at nine cases, remaining almost unchanged at ten cases in 2010-2011

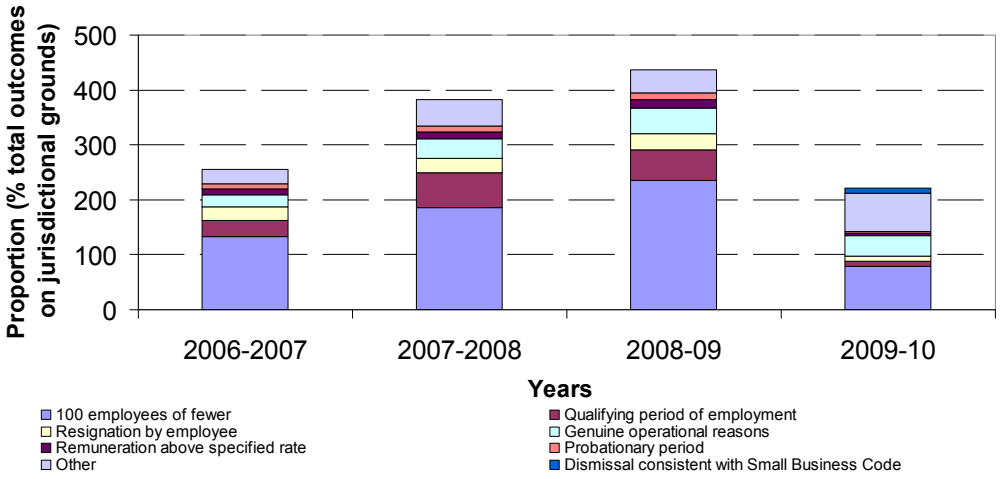
[24] Recall that the *Fair Work Act* reduced the threshold from businesses with less than 100 to those with less than 15 employees, and gave them the Code to follow rather than exempting the latter entirely from the scope of the Act.

Third, we see that the implementation of the *Fair Work Act* has coincided with an increase in unfair dismissal claims rejected for failure to respect the qualifying period of employment. It sharply increased from 10 to 28.

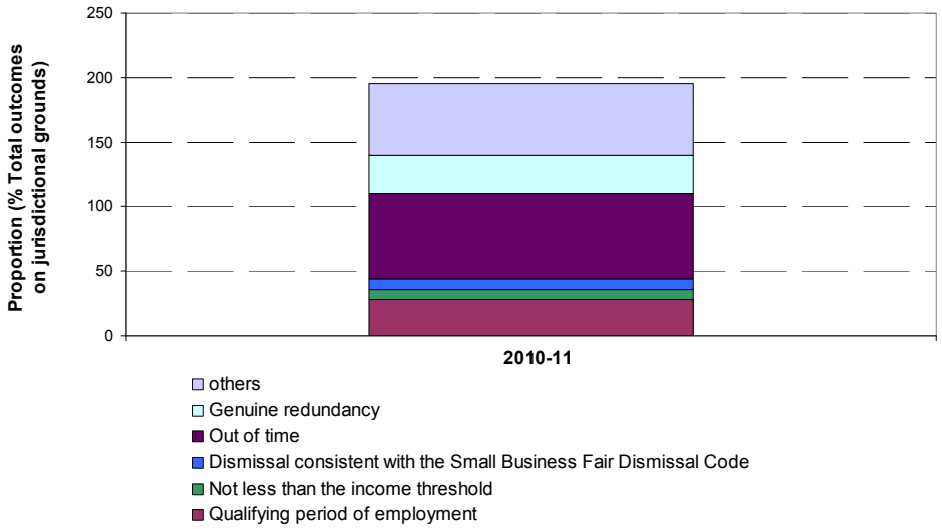
However, we remain cautious to draw any conclusions for two reasons: the fact that the *Fair Work Act* was implemented in June 2009 means we cannot infer any significant interpretations from the year 2009-10. It may be that cases filed during *Work Choices* were resolved after the *Fair Work Act* came into effect. In addition, the period of time since the *Fair Work Act* has been implemented is too short to obtain a clear view of the effects of the reform.

**Chart B.4 Jurisdictional grounds for dismissing unfair dismissal claims (2006-11)**

**(a) Under *Work Choices***



**(b) Under the *Fair Work Act***




*Source*: AIRC Annual and quarterly reports; Author's calculations.

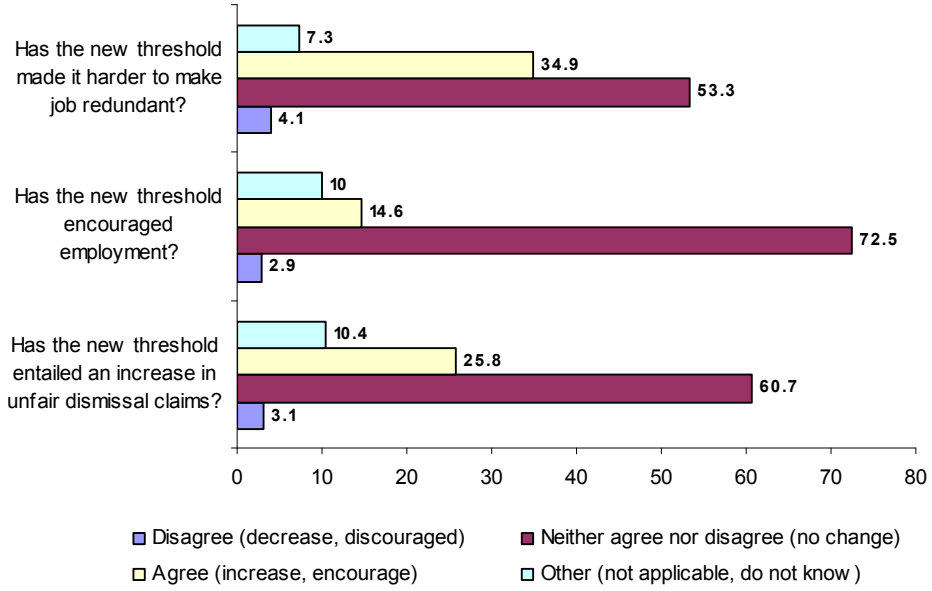
## 3.2 Business perceptions: The *Fair Work Act* survey report 2012

The *Fair Work Act* survey report[25] attempts to analyse the direct impact of the *Fair Work Act* on business environment. This online survey seeks the views of 690 human resources professionals on the impact of the 2009 reform, with a special focus on labour management.[26] It was first commissioned by the *Australian Human Resources Institute* in 2006.

[25] Downloadable at www.resource.**ahri**.com.au/press/downloads/downloader.php
[26] 2011 report.

The survey is divided into different areas of management, one of which deals with the threshold reduction. Results are summarised in Chart B.4 below:[27] it is worth bearing in mind, however, that the majority of the sample was larger businesses. Given that such firms were not affected by the exemption, these results should be interpreted with caution. The majority of firms surveyed (58%) perceived an increase in labour costs following the reform while only a marginal proportion (2%) indicated a decrease. Meanwhile, two thirds (72.5%) reported no change in hiring practices as a result of the new threshold. While 15% indicated that it has in fact discouraged hiring, only 3% reported employment growth as a result.

**Chart B.5: Business perception of unfair dismissal under the *Fair Work Act* (January 2012)**




*Source:* Australian Human Resources Institute.

[27] It is important to keep in mind that before June 2009, the threshold was established at 100 employees before being reduced to 15 employees. Therefore, the impact has to be interpreted as a tightening of the law rather than a relaxation.

### 3.3 Unintended consequences of the reform: political acceptance of *Work Choices*

Employment regulation reform is often the subject of intense political debate. Although our analysis principally focuses on the *Fair Work Act*, it seems relevant to touch briefly on the political aspects of *Work Choices*, given that the former was only implemented in 2009. *Work Choices* was the first time Australian law exempted a category of firm from unfair dismissal.

Much commentary has been made on this reform.[28] Many observers considered *Work Choices* an attempt by the Liberal-National coalition government to limit trade union powers and collective bargaining enforcement in the workplace.

Others posit that the presence of this exemption, along with the creation of fair dismissal for genuine operational reasons has disproportionately reduced legal protection of job security.

As a result, several protests were staged during this period[29] and support for the reform remained very low. One opinion survey indicated that a year later, only 20% of voters were in favour of *Work Choices.*[30] In addition, a relatively strong consensus has emerged among analysts that the implementation of this reform was one of the most important factors contributing to the defeat of the incumbent government by the Labour party during the general election in 2007.[31] This outcome may account for the subsequent reduction to firms with less than 15 employees under the *Fair Work Act.*

[28] See for example, Burgess and Waring (2005) and Forsyth and Sutherland (2006) for the impact on productivity and trade union power, respectively.
[29] Especially the Australian Council of Trade Unions (ACTR) launched a campaign called "Your rights at work" which received the support of more than 170,000 people and led to several campaigns of protests across the country.
[30] http://www.abc.net.au/news/2007-03-26/more-than-55pc-of-australians-oppose-workchoices/2226256.
[31] See for example McCallum (2007).

# 3- Spain

The case of Spain differs somewhat from the two previous case studies. First, as we will see in the next section, Spanish employers face the highest level of severance payment among OECD countries. This characteristic can be seen as crucial since it is likely to amplify the effect of a reduction in dismissal costs. Secondly, the reform differs from changes to the German *Protection against Dismissal Act* and the Australian *Fair Work Act* in that it was not targeted at small businesses.

Under the *45/2002 Act,* employers are not *explicitly* exempt from any particular unfair dismissal regulations but instead have the power to dismiss an employee *at will*, under the condition that a substantial severance payment is paid to the dismissed employee. This reform was a major change, targeted at a problematic area.

This policy was intended to reduce dismissal costs for employers by offering a means of dismissal with little or no administrative cost. The objective was also to rebalance power towards employers. Finally, the reform was intended, by relaxing regulation of permanent contracts, to reduce the proportion of temporary workers, which accounted for more than 35% of the workforce in 2002 and had steeply increased since early 1980s, following the successive implementation of *two tiered* reforms in the labour market.[32]

Therefore the situation in Spain has similarities to that of Germany over the last decade. The Spanish government decided to promote the use of temporary contracts while maintaining open-ended contracts which are heavily protected from dismissal (a similar objective to the *Job AQTIV Act* and the Hartz Commission in Germany). The result was an increase in proportion of temporary and atypical workers, at the expense of permanent workers over the 1990s.[33]

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[32] Most notably, in 1984 Spanish government introduced a reform (called the *contrato temporal de fomento del empleo*) which permitted temporary contracts to be employed for up to three years.

[33] An attempt to strengthen the conditions of dismissal for temporary workers has been undertaken, however, via the *European Temporary and Agency Work Directive* in 2008. Although this reform was essentially intended to harmonise the law across national markets, and thus reduce the effect of *social dumping*, it seeks in the meantime to guarantee that those working through employment agencies benefit from equal pay and conditions as permanent employees in the same business doing the same job.

# 1- Reform background

## 1.1 Definition

In 2002, Spain increased the flexibility of dismissal processes through the enactment of the *45/2002 Act.* This legislation introduced a dismissal mechanism similar to the concept of *compensated no-fault dismissal*[34] that is currently the subject of the aforementioned call for evidence in the UK.

Prior to the reform, if a dismissal was deemed unfair either by a court or via a pre-trial agreement, an employer had to pay intervening wages[35] in addition to severance pay. Now, an employer can avoid paying the former if he or she provides severance payment equal to the statutory compensation for unfair dismissal within 48 hours of issuing a dismissal letter. Even if the employee prevails on a subsequent unfair dismissal claim, the employer still would not have to pay intervening wages.

The idea, however, is that an employee would no longer have an incentive to file a claim given that he or she had already received the maximum amount of compensation possible. Indeed, with this reform employers have a rapid way to dismiss workers, while employees, though losing significant employment protection, obtain a significantly larger severance payment compared to the payment they would have received had they been dismissed due to economic reasons (more than double).

In doing so, the employer recognises *de facto* that the dismissal is unfair. This is a key distinction from the reform under consideration in the UK which would consider neither party to be at fault or to have acted unfairly. The Spanish system exempts certain categories of specially protected individuals, such as pregnant women or employees on maternity / paternity leave.

[34] This reform was not instantaneous but resulted rather from a series of deregulatory steps carried out from the mid-1990s: most notably, the introduction of dismissals for *economic reasons* in 1994 and the reduction of severance payments for unfair dismissals on economic grounds in 1997.

[35] That is, the wages from the date of dismissal to the judicial decision.

### 1.2 Scope

This reform applies to all businesses in Spain, regardless of size. For that reason, we will not explore the proportion of small businesses.

## 2- Institutional features and dismissal procedure in Spain

### 2.1 Grounds for dismissal

Under Spanish law, employee dismissal is justified for two reasons:

a) Objective causes: incompetence of the employee; failure of the employee to adapt to technical modifications of his or her role, if the changes were reasonable and implemented at least two months prior to dismissal; technical, organisational, economic reasons;[36] and persistent absenteeism.

b) Disciplinary causes: repeated and unjustified absence/lateness; subordination or disobedience; verbal or physical abuse; breach of contractual good faith and abuse of trust; continuous default on work duties; habitual drug abuse which interferes with work; and harassment.

It is also worth bearing in mind that like Germany, Spain resolves employment disputes via litigation in labour courts, rather than an employment tribunal.

[36] Economic reasons apply when a firm's results were negative for three consecutive quarters in terms of actual or expected losses or if there has been a continuous drop in sales or income. In such circumstances, a tribunal will evaluate the fairness of the dismissal based on the following factors: was the notice procedural properly followed, has the employee been compensated where appropriate, are there other procedures to follow and what do they cost, and are there barriers to their use?

## 2.1 Notification of dismissal procedure and probationary period

The notice period for objective dismissals is 15 calendar days. Notice must be written and include a detailed explanation of the underlying reasons for dismissal.[37] If the notice period is not respected, the employer must pay compensation equivalent to the salary which would have been earned during the defaulted period.

If the dismissal is based on disciplinary reasons, no notice is required.

If not regulated by a collective agreement, Article 51(4) of the *Worker's Statute* determines an employee's maximum probationary period:

(a) Three months for a small business (less than 25 employees)

(b) Two months otherwise

## 2.2 Remedies and severance payments

When a dismissal claim is filed with the court, there are three distinct types of outcome:

a) Dismissal is justified: the reason for termination of employment is deemed sufficiently serious and relevant. The payment owed depends on the basis of the dismissal:

   a. Objective basis: in this case, the firm must pay the employee 20 days of severance pay for each year worked (with a cap of 12 months) plus the cost of the 15 day notice period.

   b. Disciplinary basis: no severance or compensation is required in this instance.

[37] During this notice period, an employee may spend six hours per week to seek a new job.

b) Unfair dismissal: the reason for dismissal is deemed insufficient or not proven. The employer can either provide severance pay or reinstate the employee[38]. Severance pay is equal to 33 days of salary for each year of service[39] (with a maximum of 24 months) plus salary from the date of dismissal to the court decision.[40] Additionally, an employer's failure to comply with administrative formalities (notice periods, severance payment, etc.) will automatically lead to an unfair dismissal decision.

c) Null dismissal: where the court holds that the dismissal is discriminatory or breaches the employee's constitutional rights. In this case, the employer may be required to reinstate the employee with back pay

An important feature of the Spanish system is that judges are legally obligated to decide any ambiguous dismissal cases in favour of the employee. This obligation may change, however, once current and ongoing reform regulations are implemented.

### 2.3 Role of third parties

Workplace representation in Spain has a clear legal framework. The right to elect representatives applies to workplaces with more than 10 employees. The role of the works council on the protection of individual employees is mainly informative and consultative. In the case of individual dismissal, there is no obligation to observe a period of consultation / negotiation with the employee representative, Notice is not required unless (i) the dismissal concerns an employee representative or (ii) is based on certain objective reasons[41] (see previous section).

In addition, employee representatives have special protection from dismissal. Such employees are given priority when employees are dismissed for economic or technical reasons. In addition, they cannot be dismissed as a result of using their rights as a works council member.

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[38] Except where the employee is an employee representative, in which case, the employee makes the decision

[39] If the employee was hired after 12th February 2012; otherwise the period is 45 days with a limit of 720 days accumulated prior to 12th February plus the post 12th February amount.

[40] With a cap to 24 months' salary since 12th February 2012, previously the cap was 42 months.

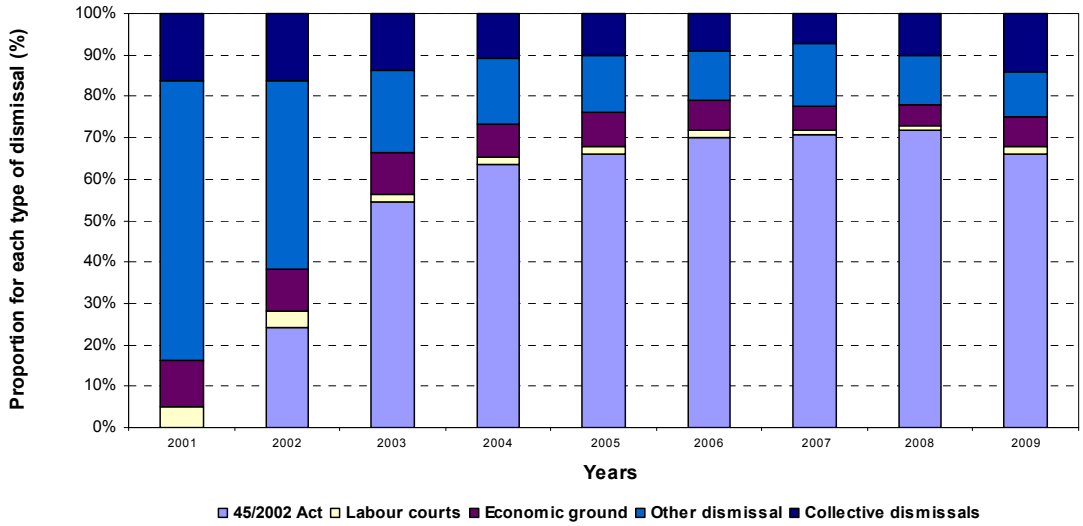
[41] Technical, organisational, economic, production related grounds which are not part of collective dismissals.

# 3- Years following the reform

## 3.1 Trends in compensated 'unfair' dismissals and total dismissals

Chart C.1 presents the distribution of the number of dismissals classified by type for the period 2001-2009. The data clearly shows that the introduction of the *Dismissals 45/2002 Act* significantly changed the management of dismissals in Spain. Indeed, the use of *compensated 'unfair' dismissal* procedures has increased since 2002 and accounted for the majority of dismissals in 2009, with a proportion equal to approximately 65%.

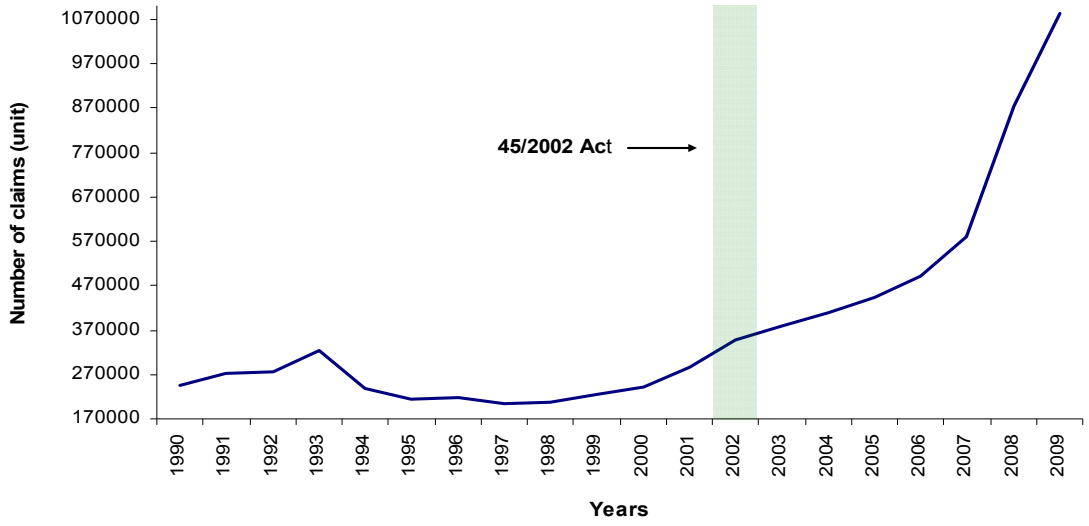
**Chart C.1: Distribution of termination of employment, by type (2001-2009)**




*Source*: International Labour Organisation, Malo (2011)

Chart C.2 also shows that the number of workers affected by individual dismissals varies between two time periods.[42] Between 1990 and 2001 there were no significant fluctuations in the number of workers affected by individual dismissals, which remained below 300,000 per year. A significant acceleration can be observed from 2002, with the number of dismissals increasing from 286,000 to 347,034 between 2001 and 2002, and steadily increasing since then. By 2009, the number of dismissals had grown to 1,082,949.

**Chart C.2: number of individual dismissals (1990-2009)**




*Source:* International Labour Organisation, Malo (2011)

## 3.2 Unintended consequences of the reform: reliance on disciplinary grounds leading to reform via the *35/2010 Act*

As previously discussed, the introduction of the *45/2002 Act* has engendered a significant shift in the type of dismissal, with this reform rapidly becoming the most frequently used type of dismissal procedure. However, this phenomenon has not occurred without any adverse effects.

[42] From 1990 until 2002, the source of information used is the number of dismissal cases as established by the mediation and arbitration public offices. However, from 2002, the statistics used come from applications for unemployment insurance and assistance from the Spanish Labour Office. This change was made in light of the fact that individual dismissals under the *45/2002 Act* are now principally solved prior to the involvement of the mediation and arbitration public offices (Malo, 2011).

It has been argued, in particular, that the reform has resulted in a *distorted* use of its intention, with unfair dismissal becoming the rule rather than the exception. The reason for this distortion is relatively straightforward: since the probability of an employer losing a case in court is very high (90%[43]), firms typically find it more profitable to dismiss an employee based on *disciplinary* grounds, using the *45/2002 Act,* rather than *economic* grounds. In the first instance, an employer would pay the highest amount of severance payment for unfair dismissal, while in the second, a firm is likely to face an unfair dismissal claim and procedural and court costs.

This problem may account for the Spanish government's decision to introduce new reforms. The most important reform in this sense is the *35/2010 Act* enacted in September 2010 which introduced, among other things,[44] a new definition of dismissal for economic reasons. Employers may still dismiss an employee using a *compensated 'unfair' dismissal* mechanism, but only pay the severance payment due for a dismissal based on *economic reasons*, i.e., 20 wage days per seniority year.

Though a detailed analysis is not relevant to this study, it is interesting to note that the proportion of dismissals under the *45/2002 Act* has significantly diminished while `dismissals for *economic reasons* (objective grounds) have sharply increased following the implementation of this new reform.[45]

[43] Bank of Spain, 2009
[44] Another change was to decrease advance notice for economic dismissals to 15 days from 30, with the additional caveat that the firm can replace even this shortened period with the corresponding wages. This reform also dealt with changing separation costs for temporary contracts, costs of dismissals, wage adjustments, working hours adjustments, financial subsidies, contracts for young people, and labour market intermediation.
[45] For more information see Malo (2011, Fig. 6, p 20).

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# ANNEX

## Annex 1: Notice periods and severance payments

Table AA.1 presents the notice periods, severance payment and qualifying period for a selection of OECD countries. Information is reported as it was in February 2012, but may be subject to modification in the future. For more information visit PLC website (www.uk.practicallaw.com) or consult the EPlex database from the International Labour Organisation (http://www.ilo.org/dyn/terminate/termmain.home)

**Table AA.1: Notice periods, severance payments, and qualifying periods across countries (February 2012)**

| Country | Notice periods (weeks) | | | Severance payment (months) | | | Qualifying period (Months) |
|---|---|---|---|---|---|---|---|
| | 6 months | 2 years | 20 years | 6 months | 2 years | 20 years | |
| **Australia** | **1** | **2.5** | **4.5** | | | | **3** |
| Belgium | 3 months (BC) ; 28 days (WC) | 9 months (BC); 28 days (WC) | 15 months (BC); 56 days (WC) | | | | 3.3 |
| Canada | 2 | 2 | 2 | - | 0.15 | 1.3 | 3 |
| Denmark | 13.5 | 13.5 | 26 | 1 | 1 | 3 | 10.5 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Germany** | **4** | **4.5** | **31.5** | | **0.5** | **1** | **10** | **6** |
| France | 4.5 | 9 | 9 | | 1/5 monthly salary for each year of service | | | 4 |
| Italy | No statutory (unless contract agreement) | | | | Sum of each annual salary divided by 13.5 | | | 0.8 |
| Netherlands | 4.5 | 4.5 | 18 | | Years of service X fixed monthly wage payments | | | 2 |
| **Spain** | **2** | **2** | **2** | | **0.3** | **1.5** | **12** | **2.5** |
| Sweden | 4.5 | 9 | 26 | | No statutory | | | 3 |
| Turkey | 4 | 6 | 8 | | Gross monthly salary X<br>years of service | | | 3 |
| **United Kingdom** | **1** | **2** | **12** | | **-** | **0.56** | **4.4** | **24** |
| United States | No statutory (unless contract agreement) | | | | No statutory (unless contract agreement) | | | - |

Note: Green: case study countries

WC= White collars; BC= Blue collars

*Source:* PLC and International Labour Organisation.

# Annex 2: OECD employment protection index (2008)

In Table AA.2 we report the results from the OECD Employment Protection Legislation Index from 2008. The index provides an overall *score*, on a scale of 0 to 6, with a higher number indicating a greater degree of Employment Protection Legislation (EPL) – more information can be found in Venn (2009) or directly to the OECD website: www.**oecd**.org/**employment/protection**

**Table AA.2: OECD Employment Protection Index (2008).**

| | Protection of permanent workers against (individual) dismissal | Regulation on temporary forms of employment | Specific requirements for collective dismissal | OECD employment protection index |
|---|---|---|---|---|
| **Australia** | **1.37** | **0.79** | **2.88** | **1.38** |
| **Belgium** | 1.94 | 2.67 | 4.13 | 2.61 |
| **Denmark** | 1.53 | 1.79 | 3.13 | 1.91 |
| **France** | 2.60 | 3.75 | 2.13 | 3.00 |
| **Germany** | **2.85** | **1.96** | **3.75** | **2.63** |
| **Italy** | 1.69 | 2.54 | 4.88 | 2.58 |
| **Netherlands** | 2.73 | 1.42 | 3.00 | 2.23 |
| **Spain** | **2.38** | **3.83** | **3.13** | **3.11** |
| **Sweden** | 2.72 | 0.71 | 3.75 | 2.06 |
| **United Kingdom** | **1.17** | **0.29** | **2.88** | **1.09** |
| **United States** | 0.56 | 0.33 | 2.88 | 0.85 |

Note: Green: case study countries

*Source*: OECD

# Annex 3: Collective bargaining coverage and level of negotiation (OECD, 2009)

Table AA.3 presents the different rate of coverage for collective agreement along with the level of bargaining.

**Table AA.3: Collective agreement coverage**

| Country | Collective agreement coverage (%) | Bargaining level |
|---|---|---|
| Australia | 60 | Company |
| Belgium | 96 | National |
| Canada | 32 | Company |
| Denmark | 82 | Industry / company |
| France | 95 | Industry / company |
| Germany | 63 | Industry |
| Italy | 80 | Industry |
| Netherlands | 82 | Industry |
| Spain | 80 | National / industry / company |

| | | |
|---|---|---|
| | | |
| Sweden | **92** | **Industry** |
| **United Kingdom** | **35** | **Company** |
| United States | **13** | **Company** |

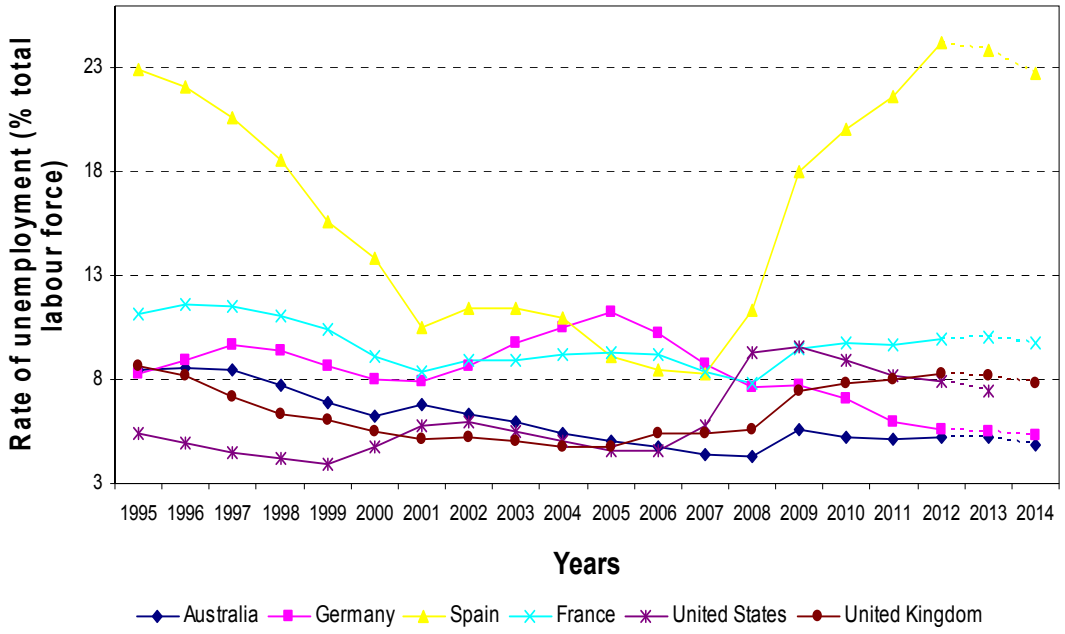
Note: Green: case study countries.

*Source:* OECD

# Annex 4: Unemployment rate (2000-2011)

Chart AA.1 presents the evolution of the rate of unemployment (ILO definition) and for the period 1995-2008. We include the three countries used as case studies (Australia, Germany, Spain), added with United Kingdom and two other developed countries (France, United States) for sake of comparison.

**Chart AA.1: Unemployment rate for selected developed countries.**




Note: Dashed line: IMF forecast.

*Source:* International Monetary Fund.

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